In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1725

IRVING BERLIN MUSIC CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Section 541 of the Internal Revenue Code of 1954 imposes a personal holding company tax equal to 70 percent of the undistributed personal holding company income. A personal holding company is defined by Section 542(a) as any corporation, 60 percent of the income of which is personal holding company income, and 50 percent of the stock of which is owned by not more than five persons.

The sole question raised by the petition, which petitioner acknowledges (Pet. 22) is one of first impression, is whether copyright royalties received and retained by petitioner under performing rights licenses issued to music users for the right to use the musical compositions of petitioner's sole stockholder, Irving Berlin, constitute "copyright

royalties", as defined by Section 543(a)(4) of the Code, Appendix, *infra*, so as to subject petitioner to the personal holding company tax.[1]

1. From its organization in 1946, petitioner has engaged in the music publishing business. During the period in question (taxable years ended January 31, 1965 and 1966), petitioner was active solely in the promotion of compositions created in whole or in part by its sole shareholder, Irving Berlin. These activities included assisting Berlin in the preparation of musical compositions for commercial and professional use, preparing arrangements of such compositions for sale to the public in sheet music form, and providing sales promotion and distribution services for such arrangements. The principal revenues derived from the exploitation of Berlin's musical compositions consisted of royalties paid for "grand performing rights," which included legitimate stage productions, electrical transcriptions, phonograph records, motion picture synchronization, stock and amateur rights, and dramatic uses on radio and television (Pet. App. A 2a-4a).

Under the terms of a January 30, 1960 agreement between petitioner and Berlin (which superseded their earlier 1946 agreement), Berlin designated petitioner to act as his exclusive licensee to publish or issue licenses to publish Berlin's compositions and as his exclusive agent to: (1) issue licenses to manufacture parts of instruments serving mechanically to reproduce his compositions; (2) issue licenses to reproduce his compositions for broadcasting purposes; and (3) issue licenses with regard to

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[1] If such receipts are personal holding company income under Section 543(a)(4), it is undisputed that petitioner is a personal holding company because at least 60 percent of its income is such income and all of its stock is owned by one person.

all performing rights to his music. Under this agreement, petitioner separately negotiated with prospective music users concerning such performing rights, and would collect royalties from such users under the licenses which petitioner issued for the use of or right to use Berlin's musical compositions. Under the 1960 contract, as under the earlier 1946 contract, petitioner was authorized to deduct, and retain as compensation for its services, 50 percent of the gross royalties paid by music users to petitioner under the performing rights licenses it issued. This arrangement represented the normal and customary percentage in the music industry for the publisher's share of gross royalties, as evidenced by the Songwriters Protective Association standard form contract (Pet. App. 2a-7a).

During the years at issue, petitioner retained $237,877 and $230,565, respectively, as its 50 percent share of the royalties paid by music users under the performing rights licenses issued by it for the use of or right to use Berlin's songs. On cross-motions for summary judgment, the Court of Claims rejected petitioner's claim that only copyright royalties paid to a corporation having proprietary interest in such copyrights are personal holding company income, and sustained the Commissioner's determination that these amounts constituted "copyright royalties" under Section 543(a)(4) of the Code and that petitioner was therefore taxable as a personal holding company (Pet. App. 7a).

2. There can be little doubt that the royalties petitioner received for performing rights were "copyright royalties" within the meaning of Section 543(a)(4). That provision specifically defines "copyright royalties" "[as] compensation, however designated, for the use of, or right to use, copyrights in works protected by copyright issued under Title 17 of the United States Code * * *, or interests

in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work * * * ." See Appendix, *infra.* In providing its own definitional section on the subject of "copyright royalties", Congress did not adopt (although it easily could have adopted) the definition of royalties contained in the copyright laws, which requires a proprietary interest in the copyright. Instead, Congress concentrated upon the central question always present in personal holding company tax litigation: whether a controlled corporation has received "passive" income derived from the right to use copyrights. The statute states with great particularity that, for purposes of the personal holding company tax, "copyright royalties" means "compensation, however designated," and includes "payments from any person for performing rights in any such copyrighted work." Thus, the Court of Claims correctly concluded that the fact that petitioner did not have a proprietary interest in the copyrights generating the royalty income is irrelevant for purposes of Section 543(a)(4). Contrary to petitioner's assertion (Pet. 13, *et seq.)* that the Court of Claims erred in looking to the "circumstances giving rise to the production of * * * income," the language of the statute itself mandates such an examination of the underlying nature of the payment.[2]

Moreover, the exclusionary language contained in Section 543(a)(4) demonstrates that Congress was aware of the potential use of a corporation to have income

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[2] Petitioner's citation (Pet. 16, *et seq.*) of authorities dealing with other factual situations and cases arising before the 1960 amendments to Section 543 which are involved in this case are of little relevance. As the Court of Claims recognized (Pet. App. 10a-11a, 19a), Congress specifically confined its definition of "copyright royalties" to Section 543(a)(4).

derived from copyrights taxed at the lesser corporate rate. As a result, Congress unambiguously decided to include shareholder-created copyright royalty income in the definition of personal holding company income. Thus, Section 543(a)(4)(A) was added to provide, together with subparagraphs (B) and (C), an exception for publisher corporations which were essentially "operating companies" even though a substantial portion of their income ordinarily consists of royalties (see S. Rep. No. 1041, 86th Cong., 2d Sess., p. 3). In order to qualify for the exclusion, a publishing corporation's copyright royalties must "constitute 50 percent or more of the ordinary gross income." Significantly, however, Section 543(a)(4)(A) provides that in determining whether this percentage of business test is met, "royalities received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder" are not to be considered. The clear intent of Congress concerning shareholder created copyright income was therefore that such income, "however designated," was to be personal holding company income when received by such shareholder's controlled corporation. See S. Rep. No. 1041, *supra*, pp. 5-6. As the Court of Claims noted (Pet. App. 17a), the facts of this case, involving a wholly-owned corporation's receipt of copyright royalty income on compositions created by its sole shareholder, illustrate "the ultimate example of Congressional concern."[3]

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[3]Petitioner also challenges (Pet. 4-13) the granting of the government's motion for summary judgment. The issue, however, is purely one of law since the decision below holds that copyright royalties are personal holding company income under Section 543(a)(4), despite the shareholder-creator's designation of such receipts as compensation for services. The question is not whether petitioner has a proprietary interest in the copyrights themselves, or whether the contract provisions designating petitioner as an "exclusive agent" are a "sham," but whether the statute should be construed to encompass royalties received under the stipulated contractual provisions.

For the reasons stated, it it respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

SEPTEMBER 1974.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) [as amended by Sec. 225 (d), Revenue Act of 1964, P.L. 88-272, 78 Stat. 19, 81.] *General Rule.*— For purposed of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

* * * *

(4) *Copyright royalties.*— Copyright royalties; except that copyright royalties shall not be included if—

(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

(B) the personal holding company income for the taxable year computed—

(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under Section 162, other than—

(i) deductions for compensation for personal services rendered by the shareholders,

(ii) deductions for royalties paid or accrued, and

(iii) deductions which are specifically allowable under sections other than Section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under Section 167 (relating to depreciation) with respect to copyright royalties.

For purposes of this subsection, the term "copyright royalties" means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under Title 17 of the United States Code (other than by reason of Section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B)) received for the use of, or right to use, films. For purposes of this paragraph, the term "shareholder" shall include any person who owns stock within the meaning of Section 544.

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